

Message Text

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ACTION EUR-12

INFO OCT-01 EA-10 ISO-00 AID-05 CEA-01 CIAE-00 COME-00
EB-08 FRB-03 INR-07 IO-13 NEA-10 NSAE-00 USIA-06
OPIC-03 SP-02 TRSE-00 LAB-04 SIL-01 AGRE-00
OMB-01 SS-15 DODE-00 PM-05 H-01 L-03 NSC-05
PA-01 PRS-01 /118 W

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TO SECSTATE WASHDC 5301
INFO AMEMBASSY BRUSSELS
AMEMBASSY LONDON
AMEMBASSY PARIS
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USEED, USOECD ALSO FOR EMBASSY
DEPARTMENT PASS TREASURY, FRB AND CEA

E.O. 11652: N/A
TAGS: EFIN, GW
SUBJECT: FRG'S ECONOMIC REPORT FOR 1978

1. SUMMARY -- JUST RELEASED ECONOMIC REPORT FOR 1978
RESTATES FRG DOMESTIC AND FOREIGN ECONOMIC POLICIES AND
OBJECTIVES AND OFFICIALLY ANNOUNCES ECONOMIC GROWTH
GOALS FOR THE YEAR. NOTE IS TAKEN OF MEASURES FRG IS
TAKING TO FOSTER HIGHER LEVEL OF EXPANSION AND SATISFACTION
IMPLIED WITH THE RECENT PICK-UP OF THE GERMAN
ECONOMY. QUESTION OF WHAT IF ANY ADDITIONAL MEASURES
FRG MIGHT TAKE IN EVENT ECONOMY FALLS SHORT OF 3.5

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PERCENT GNP GOAL IS NOT ADDRESSED. END SUMMARY.

2. FRG ECONOMIC REPORT FOR 1978 REITERATES THE VARIOUS
OBJECTIVES RESPECTING THE FRG'S INTERNATIONAL ECONOMIC
RELATIONS AND EXPRESSES GENERAL SATISFACTION WITH
THE DEVELOPMENT OF THE GERMAN ECONOMY. OF PRIMARY
INTEREST ARE THE OFFICIAL ANNOUNCEMENT OF THE FRG'S

GROWTH GOALS FOR 1978 AND THEIR RATIONALE EVEN THOUGH VIRTUALLY ALL HAD BEEN FORESHADOWED BY VARIOUS UNOFFICIAL LEAKS EXTENDING BACK TO DECEMBER.

3. THE MOST IMPORTANT GOALS ENUMERATED FOR 1978 ARE:

- REAL YEAR-OVER-YEAR GNP GROWTH OF ABOUT 3 1/2 PERCENT;
- A SLIGHT DECLINE IN THE UNEMPLOYMENT RATE FROM AN AVERAGE RATE OF 4 1/2 PERCENT FOR 1977 TO JUST UNDER THAT LEVEL;
- A DECLINE IN THE CPI RATE OF INCREASE FROM 3.9 PERCENT IN 1977 TO ABOUT 3 1/2 PERCENT IN 1978; AND
- A FURTHER DROP IN THE CURRENT ACCOUNT SURPLUS.

4. AS THE REPORT POINTS OUT, AVERAGE GROWTH OF 3 1/2 PERCENT FOR 1978 WILL REQUIRE, BECAUSE OF THE ABSENCE OF SIGNIFICANT OVERHANG AT THE END OF 1977, AN ACCELERATION OF THE GROWTH RATE TO 4.5 - 5 PERCENT DURING THE COURSE OF THE YEAR. HOPEFULLY, CAUSING THIS ACCELERATION ARE:

-- GREATER FISCAL STIMULUS AMOUNTING TO SOME DM 23 LIMITED OFFICIAL USE

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BILLION (ALMOST 2 PERCENT OF GNP) IN THE FORM OF TAX RELIEF AND LARGER PUBLIC SECTOR OUTLAYS (DM 23 BILLION IS A COUNCIL OF ECONOMIC EXPERTS CALCULATION REPRESENTING THE DIFFERENCE BETWEEN A CYCLICALLY NEUTRAL PUBLIC SECTOR DEFICIT OF DM 26 BILLION AND AN ACTUAL PUBLIC SECTOR DEFICIT OF DM 49 BILLION);

-- A REACTIVATION OF INVESTMENT, AS REFLECTED BY A SHARP PICK-UP IN DOMESTIC ORDERS SINCE JUNE AND BUILDING PERMITS, AND A CONTINUATION OF THE RECENT IMPROVEMENT IN CONSUMPTION;

-- SOME ACCELERATION IN THE ECONOMIES OF THE FRG'S PRINCIPAL TRADE PARTNERS AND EXCHANGE RATE STABILITY SO AS TO ALLOW FOR A FIVE PERCENT GROWTH IN EXPORTS;

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FM AMEMBASSY BONN
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-- WAGE BILLS (RISING BY AN ESTIMATED 5 1/2 PERCENT)
TO MAINTAIN A FINE BALANCE BETWEEN SUFFICIENT INCOME
EXPANSION ON THE DEMAND SIDE AND NOT TOO MUCH COST-
PUSH ON THE SUPPLY SIDE SO AS TO RAISE THE INFLATION
RATE AND DAMPEN INVESTMENT; AND

-- FEDERAL GOVERNMENT AND LAENDER COOPERATE TO ACHIEVE
FRG INVESTMENT OBJECTIVES.

6. THE REPORT DOES NOT DIRECTLY ADDRESS THE QUESTION
AS TO WHETHER THE FRG COULD PURSUE MORE EXPANSIONARY
FISCAL/MONETARY POLICIES. BUT BY IMPLICATION THE REPORT
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PRETTY WELL SLAMS THE DOOR ON MORE STIMULATION, AT
LEAST FOR THE PRESENT. ESSENTIALLY ITS ARGUMENT RUNS
THUS: HIGH UNEMPLOYMENT REFLECTS NOT INSUFFICIENT
DEMAND BUT STRUCTURAL PROBLEMS, PARTICULARLY IN THE LABOR

MARKET. ON THE ONE HAND, THE GERMAN ECONOMY HAS DEVELOPED TO THE POINT WHERE IT CAN NO LONGER FOLLOW THE LEAD OF PRODUCT INNOVATORS. ENTREPRENEURS, HOWEVER, HAVE TO BE COMPENSATED FOR THE RISKS ASSOCIATED WITH NEW PROCESSES AND NEW PRODUCTS. THE REPORT WELCOMES THE SHIFT IN AN EXPECTED, ALBEIT SMALL, SHIFT IN INCOME DISTRIBUTION SHARES IN FAVOR OF CAPITAL. IN THIS CONNECTION, IT ALSO SUGGESTS THAT THERE IS A GREATER RISK OF WAGE SETTLEMENTS EXCEEDING THAN UNDERSHOOTING THE LEVEL NEEDED FOR ECONOMIC GROWTH AND BALANCE. ON THE OTHER HAND, A NARROWING OF THE WAGE SPREAD HAS REDUCED THE INCENTIVE TO LABOR TO TAKE EMPLOYMENT IN GROWTH AREAS AND INDUSTRIES. AN INCREASE IN OVERALL DEMAND WOULD THEREFORE OBSCURE RATHER THAN CORRECT THESE STRUCTURAL PROBLEMS. THE ROLE OF BUSINESS IS TAKE THE RISKS OF INNOVATION; THE ROLE OF GOVERNMENT IS FACILITATIVE -- REMOVING LEGAL AND FISCAL BARRIERS TO STRUCTURAL CHANGE AND MAINTAINING THE APPROPRIATE AMOUNT OF GLOBAL DEMAND, WHICH IT IS ALREADY DOING.

7. NOTE IS TAKEN OF RECENT MEASURES TO MODERATE EXCHANGE RATE FLUCTUATIONS WITH THE DOLLAR. THE REPORT ASSUMES THAT FRG EXPORTS WILL EXPAND AT THE SAME PACE AS WORLD TRADE (5 PERCENT) BUT ACKNOWLEDGES THAT THIS ASSUMPTION WOULD BE JEOPARDIZED BY EXCHANGE RATE TURBULENCE OR BY MORE TRADE PROTECTIONISM.

8. COMMENT -- A SOPORIFIC PRODUCTION, THE ECONOMIC REPORT IS UNLIKELY TO STIR MUCH DOMESTIC INTEREST
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EXCEPT POSSIBLY WITH RESPECT TO THE 5.5 PERCENT WAGE BILL INCREASE. THE AUTHORS OF THE REPORT ARE AT CONSIDERABLE PAINS TO JUSTIFY THIS AMOUNT OF INCREASE RATHER THAN THE 3.5 PERCENT RECOMMENDED (BUT NOT EXPECTED) BY THE COUNCIL OF ECONOMIC EXPERTS.

WHILE THE REPORT ENDORSES A 3.5 PERCENT GNP GROWTH RATE AS FEASIBLE, ITS TONE SUGGESTS THAT THIS GOAL IS QUITE SENSITIVE TO SOME STRONG ASSUMPTIONS, PARTICULARLY AS RESPECTS EXCHANGE RATE STABILITY AND WAGE NEGOTIATIONS.
END COMMENT.

8. BELOW ARE LISTED THE REPORT'S MAIN PROJECTIONS FOR 1978 AND PROVISIONAL FIGURES FOR 1977 ROUNDED TO THE NEAREST HALF PERCENTAGE INCREASE (EXCEPT WHERE OTHERWISE STATED):

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1977 1978

EXPENDITURE OF PRODUCT

(CURRENT PRICES)

PRIVATE CONSUMPTION 7 6 1/2 - 7 1/2

PUBLIC CONSUMPTION 6 6 1/2 - 7 1/2

FIXED INVESTMENT 6 1/2 8 - 9

OF WHICH PUBLIC INVEST. -0 9 - 11

INVENTORIES (DM BILLION) 12 1/2 14 - 16

GROSS NATIONAL PRODUCT 6 6 1/2 - 7 1/2

DOMESTIC DEMAND 6 1/2 6 1/2 - 7 1/2

NET FOREIGN BALANCE (DM BIL.) 25 1/2 23 - 25

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PRICE DEFLATORS

CPI 4 3 1/2

DOMESTIC DEMAND 4 3 1/2

GNP 3 1/2 3 1/2

DISTRIBUTION OF PRODUCT

NATIONAL INCOME 5 1/2 6 1/2 - 7 1/2

GROSS INCOME FROM

ENTREPRENEURSHIP

AND PROPERTY 2 1/2 9 - 11

GROSS SALARIES AND WAGES 7 5 1/2

SAVINGS RATIO (PERCENT OF

DISPOSABLE INCOME) 13 1/2 14

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